Before the
Federal Communications Commission
Washington, D.C. 20554

In the matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)))	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	))	CC Docket No. 98-77

COMMENTS OF THE INDEPENDENT TELEPHONE & TELECOMMUNICATIONS ALLIANCE

The Independent Telephone & Telecommunications Alliance ("ITTA") hereby submits its comments in response to the Commission's Notice of Proposed Rulemaking (the "Notice") in the above-captioned proceedings.[1]

I. INTRODUCTION AND SUMMARY

ITTA is an organization of midsize local exchange carriers. Many ITTA members operate both as incumbent local exchange carriers ("ILECs") and as competitive local exchange carriers ("CLECs"). ITTA members collectively serve more than eight million access lines in over 40 states, where they offer a diversified range of services to their customers. ITTA's smallest member company serves just under one hundred thousand access lines, while its largest serves more than two million. While most ITTA members are regulated by the Commission under rate-of-return regulation, certain, such as Cincinnati Bell Telephone Company and Citizens Communications, have elected price cap regulation. Most ITTA members qualify as rural telephone companies within the meaning of Section 3(37) of the Communications Act of 1934 as

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1 *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and

amended ("Act").[2] Midsize carriers have a range of interconnection obligations, which vary with size and with status as a rural or non-rural carrier. In some cases, ITTA member carriers that once qualified for the rural carrier exemption from certain interconnection obligations pursuant to Section 251(f) of the Act no longer enjoy those protections.

ITTA believes the Commission should adopt regulations that allow small and midsize carriers to elect an appropriate regulatory plan for their companies and their markets. Such regulation will produce consumer benefits without discouraging investment in small and midsize markets. ITTA urges the Commission to eliminate the price cap all-or-nothing and one-way-door rules, encourages the Commission to make any new incentive regulations optional by study area, and supports the Commission's move to expand pricing flexibility to include all carriers facing competition.

II. THE COMMISSION SHOULD IMMEDIATELY ELIMINATE THE PRICE CAP ALL-OR-NOTHING AND ONE-WAY DOOR RULES

A. The Commission Is Unnecessarily Overcomplicating This Issue

In the Notice, the Commission spends seven pages contemplating whether to formally eliminate the price cap all-or-nothing rule and the one-way door rule.[3] The answer is an unqualified "yes." These rules (1) deter and delay carriers from innovating, expanding, and competing with each other; and (2) continue to be unnecessary to prevent carriers from cost-shifting or otherwise gaming the system. These rules harm consumers, carriers, and competition

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Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, FCC 01-304, 16 FCC Rcd 19613 (2001).

[2] 47 U.S.C. § 153(37).

[3] 47 C.F.R. § 61.41(b) requires that if a carrier files a price cap tariff in one study area it must file price cap tariffs in all its study areas. 47 C.F.R. § 61.41(d) prohibits carriers who elect price cap regulation from withdrawing from price caps. As a corollary to these rules, 47 C.F.R. § 61.41(c) requires a rate-of-return carrier, for example, that acquires price cap exchanges, to convert its entire operation to price caps.

by adding uncertainty and cost to the transactions carriers enter into, and by deterring carriers from adopting alternative rate plans that would otherwise benefit consumers.

The United States House of Representatives recognizes this and has twice approved legislation that would mandate immediate changes that the Commission is now considering.[4] This legislation specifies that any midsize carrier "may elect to be regulated by the Commission under price cap rate regulation, or elect to withdraw from such regulation, for one or more of its study areas at any time," and directs that "[t]he Commission shall not require a carrier making an election under this paragraph with respect to any study area or areas to make the same election for any other study area."[5]

In addition, it is clear the Commission has already reached this conclusion on a *de facto* basis, as the Commission has granted one waiver application after another over the years.[6] Decisional precedent shows that the Commission has rarely, if ever, enforced the price cap all-or-nothing or one-way door rules, because it already understands that these rules do not serve the purpose for which they were originally intended.[7] Each time the Commission has granted a carrier request for waiver of the one-way door rule or an extension of time to comply with the all-or-nothing rule, it has effectively acknowledged that there are adequate safeguards already in place to protect the public and that the public interest is better served by a departure from the rules.

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4 H.R. 3850, 106th Cong., § 2(a)(4) (2000); H.R. 496, 107th Cong., § 2(a)(4) (2001). This legislation has also been introduced in the U.S. Senate as S. 1359, 107th Cong. (2001).

5 *Id.*

6 *See* Appendix A, attached hereto (extensive list of waivers).

7 When the Commission originally imposed price caps, it concluded that the all-or-nothing rule was necessary to prevent LEC holding companies from shifting costs from price cap affiliates to rate-of-return affiliates, *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, ¶ 271 (1990) (*LEC Price Cap Order*) (subsequent history omitted), and the one-way-door was needed to prevent LEC holding companies from "fattening up" under rate-or-return regulation and "slimming down" under price caps. *See, id.* at ¶ 269. The Commission also noted, that "[a]s price cap regulation develops, however, we will monitor the situation carefully" to determine if "less burdensome, non-structural mechanisms" could be employed. *Id.* at ¶ 273.

B. These Rules Have Long Outlived Whatever Usefulness They Ever Had

The Commission's rules already prohibit cost-shifting between affiliates.[8] It is clear that the Commission already understands that the actual risk of cost-shifting in this manner is insignifigant: Since 1999, the Commission has granted extensions of time to come into compliance with the all-or-nothing rule to both ALLTEL and Verizon without imposing any particular safeguards to prevent cost-shifting.[9] After over two years, there is no evidence that either carrier is engaging in any systematic effort to shift costs to its rate-of-return affiliates.

Furthermore, even if the price cap all-or-nothing rule and one-way door rule were repealed, any carrier attempt to engage in illegal cost shifting would likely be detected both by the Commission and by its access customers. Such an attempt to cost-shift could lead to enforcement action and civil penalties under the Commission's existing enforcement authority.[10]

First, as a matter of general practice, midsize carriers are likely to keep price cap exchanges and rate-of-return exchanges in different operating companies. ITTA does not believe that separate affiliate safeguards should be mandated in this context.[11] Indeed, the Commission has already proposed eliminating this requirement for independent ILECs in the interexchange

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8 *E.g.*, 47 U.S.C. § 254(k) (requiring that prices charged for universal services be free of improper charges); 47 C.F.R. § 64.901 (specifying mechanisms for allocating costs); and 47 C.F.R. § 32.27 (establishing strict rules for transactions between affiliates).

9 The Commission has allowed rate-of-return carriers to return price cap exchanges to rate-of-return regulation; has allowed rate-of-return carriers to operate price cap exchanges without converting the affiliated exchanges to price cap; and has permitted a mandatory price cap carrier to delay conversion of purchased rate-of-return exchanges to price caps. *See e.g.,*; *Puerto Rico Tel. Co. Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission's Rules*, Order, 16 FCC Rcd 12343 (2001) (permitting Puerto Rico Telephone Company to continue to operate under rate-of-return regulation following acquisition by price cap carrier); *see also Puerto Rico Tel. Co. Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission's Rules*, Order, 15 FCC Rcd 9680 (2000); *Puerto Rico Telephone Authority, Transferor, and GTE Holdings (Puerto Rico) LLC, Transferee, For Consent to Transfer Control of Licenses and Authorization Held by Puerto Rico Telephone Company and Celulares Telefónica, Inc.,* Memorandum Opinion and Order, 14 FCC Rcd 3122 (1999).

10 47 U.S.C. § 501, *et seq*.

11 In fact, H.R. 496 would specifically prohibit the Commission from requiring "any two percent carrier to establish or maintain a separate affiliate to provide any common carrier or non common carrier services, including local and interexchange services . . . ."

context in a separate proceeding, and should not reinstitute those requirements here.[12] Nevertheless, experience with Verizon, ALLTEL, and CenturyTel shows that (1) all-or-nothing issues involving the creation of price cap and rate-of-return affiliates arise most often in the acquisition context; and (2) the most common operating structure carriers propose is to segregate price-cap exchanges in distinct operating companies.[13]

Second, price cap exchanges and rate-of-return exchanges operated by a carrier will not overlap. This geographic diversity, as the Commission has noted, makes cost-shifting more detectable (and therefore less likely) as well.[14]

Third, the tariff review process provides an annual opportunity for the Commission, IXCs, and consumer groups, to examine the ILECs' tarriffs for any evidence of cost-shifting. The cost support documentation accompanying these tariffs provides a detailed financial picture of the carriers' costs. Any substantial year-over-year changes in cost will be readily identifiable.

As the Commission acknowledges in the Notice, rules such as the price cap all-or-nothing rule and the one-way door rule are often enacted based on "informed prediction,"[15] and such predictions often need fine tuning. While it may have made sense for the Commission to err on the side of caution initially, it makes at least equal sense now to remove rules that have turned

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12 *See 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, CC Docket No. 00-175, Notice of Proposed Rulemaking, FCC 01-261, ¶ 8 (rel. Sept. 14, 2001).

13 In addition to the Verizon and ALLTEL examples citied above, CenturyTel has also proposed to operate 675,000 lines that it is acquiring from Verizon in Alabama and Missouri in distinct price cap affiliates. *See Public Notice, CenturyTel Files Petitions to Waive the Commission's "All-or-Nothing" Rule (Section 61.41) and Clarify the Availability of Interstate Access Universal Service Support (Section 54.801) for Exchanges to be Acquired in Missouri and Alabama*, CCB/CPD Nos. 01-30 and 01-36, DA 01-2974 (rel. Dec. 21, 2001). *See also Public Notice, ALLTEL Corporation Files a Petition to Waive Sections 61.41(b) and (c)(2)*, 16 FCC Rcd 21934 (2001).

14 *See Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report And Order In CC Docket No. 96-149 And Third Report And Order In CC Docket No. 96-61, FCC 97-142, 12 FCC Rcd 15756 at 15875 (¶ 209) (April 18, 1997) (noting that geographic separation "mitigates the potential for undetected improper allocation of costs.").

15 *Notice* at n.608. *See also National Rural Telecom Assoc. v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

out to be unnecessary – especially given the substantial and opportunity costs they place on the industry and the general public.[16]

III. THE COMMISSION SHOULD MAKE INCENTIVE-BASED ALTERNATIVE RATE REGULATION FOR RATE-OF-RETURN CARRIERS OPTIONAL BY STUDY AREA

As the Commission moves to introduce incentive-based regulation, it should continue to recognize that it is virtually impossible to create a single alternative regulatory plan that will meet the needs of all rate-of-return operating companies.[17] As the Commission creates an incentive plan to encourage carriers to deploy advanced telecommunications capability and to assure reasonable comparability of services between rural and urban areas at affordable rates, it should make the plan optional and allow carriers to elect the plan on a study area basis. This would accelerate many consumers' access to the improved value and services that is the goal of such a plan.

To begin with, many carriers operate in study areas that are widely diverse.[18] As the Commission recognized when it adopted price caps, alternative regulation "may be more attractive to one affiliate than another."[19] Therefore, especially given that history has shown that the all-or-nothing rule is unnecessary in the price cap context, the Commission should not make the mistake of adopting an all-or-nothing rule for rate-of-return carrier incentive regulation.

Moreover, underlying all of these concerns is the reality that small and midsize carriers are different from large price cap carriers.[20] With higher costs, more widely dispersed

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[16] Along these lines, removing these rules now dovetails well with the Commission's ongoing Section 11 obligations to repeal regulations that are no longer necessary in the public interest. 47 C.F.R. § 161.

[17] *Notice* at ¶ 227. ("Given the wide variations among rate-of-return carrier operating conditions, we believe it would be extremely difficult to establish a mandatory alternative regulatory plan for all rate-of-return carriers."). *See also* Rural Task Force, *The Rural Difference*, White Paper #2 at § IIA ("Unique Challenges of Rural Carriers") and § IIB ("The Challenge of Low Population Density") (January, 2000) (*Rural Task Force White Paper #2*).

[18] *LEC Price Cap Order* at ¶ 263.

[19] Id. at ¶ 275.

[20] As the Commission has rightly noted, "any sudden change in the support mechanisms" for rural carriers, "may disproportionately affect rural carriers' operations." *Federal-State Joint Board on Universal Service*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of

customers, and smaller revenues than the larger carriers, small and midsize carriers are necessarily and understandibly cautious when it comes to changes in the regulatory environment that may dramatically disrupt their entire operations. If the incentive plan that the Commission adopts turns out to be well designed, carriers will adopt it in a few study areas at first and then embrace it wherever feasible within a reasonable period.

IV. THE COMMISSION SHOULD GRANT PRICING FLEXIBILITY TO RATE-OF-RETURN CARRIERS

A. The Commission Should Stop Delaying The Advent Of Pricing Flexibility For Non-Price Cap Carriers

Some ITTA member carriers such as ACS of Alaska and ACS of Fairbanks currently operate in some of the most competitive service territories in the nation.[21] Nevertheless, during the last two years only the price cap carriers have received pricing flexibility.[22] The FCC has never justified this disparate treatment, despite the fact that ACS's Anchorage market was one of the first of any markets to be declared subject to effective local competition.[23]

ITTA applauds the Commission for moving now to correct this imbalance, and encourages the Commission to quickly adopt triggers that take into account the unique and diverse

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Proposed Rulemaking in CC Docket No. 96-45, Report and Order in CC Docket No. 00-256, FCC 01-157 (May 23, 2001).

[21] *E.g. ATU Telecommunications Request for Waiver of Sections 69.106(b) and 69.124(b)(1) of the Commission's Rules*, Order, 15 FCC Rcd 20655, 20661-62 (¶¶ 19-21) (2000) (finding competitor collocated in 100 percent of wire centers, providing service throughout Anchorage market, making "it unlikely that [ACS] could lock-up the market and preclude competition from developing further") (*ATU Waiver Order*).

[22] *See Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999). *See also ATU Telecommunications Petitions for a Waiver of the Commission's Rules to Offer Term and Volume Discounts for Switched Access Services*, DA 98-1229 (June 24, 1998).

[23] *ATU Waiver Order at ¶ 14* ("The record before us demonstrates that the level of competition in the Anchorage market is sufficient to conclude that special circumstances exist. Since 1997, GCI and AT&T Alascom have been approved to offer local exchange and exchange access services directly in competition with ATU.")

factual situations small and midsize carriers face so that these carriers may respond adequately to competitive pressures and improve the range of services they are able to offer their customers.[24]

B. The Commission Should Adopt Pricing Flexibility Triggers Tailored To The Needs Of Small And Midsize Carriers

As the Commission has noted, pricing triggers that are well suited for the large price cap carriers may be completely inadequate if they are applied to the far smaller midsize carriers.[25] The time has come to create sensible triggers for small and midsize carriers. When *market forces* make a carrier unwilling or unable to raise rates above market levels, restrictive regulation is simply no longer necessary to protect consumers. Furthermore, to the extent that such regulation interferes with the market in the first place, and introduces additional inefficiencies into the system, such regulation should be eliminated as quickly as possible.[26]

Current triggers, such as counting collocations or cross-connects, may act as sensible proxies for the existence of competition in a market where a carrier's competitors are demanding collocation or cross-connecting with them. Many ITTA members, however, have very few wire centers or have such low traffic volumes that these sorts of numerical triggers do not accurately indicate whether competition is present. For example, if the current trigger (based on percentage of wire centers with collocation) were to be applied to a small company that has only two wire centers, even having a fully collocated competitor in one of those two wire centers would be insufficient to trigger pricing flexibility under the rule that was designed for the BOCs. Nevertheless, such a competitor could have customers representing a sizeable portion of the

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[24] *Notice at ¶ 6; 247* ("[R]ate-of-return carriers are not insulated from competitive pressures. High per minute charges may place them at a disadvantage in competing with new market entrants . . . . As competition develops in the service areas of rate-of-return carriers, it is important that they have pricing flexibility").

[25] *Notice* at ¶ 247 ("We recognize that the competitive levels used for price cap carriers may be overly restrictive for the smaller rate-of-return carriers.").

[26] Once again, this is exactly the type of regulation that Section 11 of the Act requires the Commission to modify or repeal during each biennial review. 47 C.F.R. § 161.

ILEC's customer base, making pricing flexibility essential for the ILEC to respond to the competition and to the needs of its customers.

Furthermore, many of the most formidable competitors in the telecommunications arena, such as CMRS, satellite, and cable, require *no collocation whatsoever*. The current triggers would tie the hands of the ILEC while new entrants enter the market and cherrypick the most profitable customers. Moreover, some competitors can begin operations in any region they choose in a relatively short period of time.[27] Without appropriate triggers for small and midsize carriers, a CMRS provider, for example, could deploy a single tower near a large office park located in a predominately rural area and offer the tenants there volume discounted service at prices far below what they are currently paying their ILEC, due primarily to (1) cost savings associated with volume discounts; and (2) cost savings associated with a different service footprint and a lesser standard of service. Yet even as the wireless carrier is collecting universal service support based on ILEC's costs, the ILEC could not respond to the CMRS carrier's pricing promotions. Paradoxically the net result of this regulatory quirk would be that affected consumers could pay *higher* prices than they would if pricing flexibility triggers were met and the ILEC was allowed to compete.[28]

The Commission should thus consider the nature of small and midsize carrier customer bases when formulating suitable competitive triggers for rate-of-return carriers. In many cases, a rural ILEC may only serve a very few medium- or large- business customers that

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[27] As the Commission noted recently for example, wireless networks in defined areas can now be established in a matter of days. *See Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Third Report, CC Docket 98-146, FCC 02-33 at ¶ 110 (Feb. 6, 2002) (the Broadband Wireless International Corporation recently "installed and tested a high-speed, broadband wireless network service" across the entire "Hopland Band of Pomo Indians reservation in three days," and "StarBand Communications and Northern Arizona University are working to provide satellite based Internet access to 120 locations within the Navajo, Hopi, and Havasupai reservations") (*citations omitted*).

[28] This is especially important given that A rate-of-return carrier that experiences a decline in demand must nevertheless recover its full revenue requirement from its remaining customers.

represent a large portion of its revenues for its entire study area. Even an apprently low level of comeptition (as measured by counting collocation arrangements) may represent a significant competitive threat to such a rural ILEC. Pricing flexibility triggers, therefore, must reflect the fact that a greater portion of small and midsize carrier revenues is typically concentrated among relatively fewer customers than is the case for larger carriers.

ITTA urges the Commission to once again follow the lead of the House of Representatives and enact triggers that give small and midsize carriers pricing flexibility when it becomes apparent that these carriers' markets are open to competition.[29] If the triggers are simple, reasonable, and easy-to-apply, carriers and customers alike will benefit from the certainty of knowing that as competition arrives, all parties will be on equal ground and customers can freely negotiate volume and term discounts as they see fit.

V. CONCLUSION

In conclusion, for the forgoing reasons, the Commission should (1) immediately eliminate the price cap all-or-nothing and one-way door rules, (2) make incentive-based rate regulation optional for rate-of-return carriers not only by operating company but by study area, and (3) grant pricing flexibility that is tailored to small and midsize carriers.

Respectfully submitted,

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[29] *See* H.R. 496, 107th Congress, § 286(a) (granting pricing flexibility after ILEC certifies presence of a facilities-based competitor in its market).

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